198609

LAW OFFICES
McCARTHY, SWEENEY & HARKAWAY, P.C.
SUITE 600
2175 K STREET, N.W.
WASHINGTON, D. C. 20037
(202) 393-5710

LAWRENCE W. BIERLEIN
DOUGLAS M. CANTER
JOHN M. CUTLER, JR.
ANDREW P. GOLDSTEIN
STEVEN J. KALISH
RICHARD D. LIEBERMAN
HARVEY L. REITER

OF COUNSEL
WILLIAM I. HARKAWAY
KAREN R. O'BRIEN
DANIEL J. SWEENEY

FACSIMILE
(202) 393-5721

E-MAIL
MSH@MSHPC.COM

WEBSITE
HTTP://WWW.MSHPC.COM

May 16, 2000

RECEIVED
MAY 16 2000
MAIL
MANAGEMENT
STB

ENTERED
Office of the Secretary

MAY 16 2000

Part of
Public Record

Mr. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

Re: Ex Parte No. 582, <u>Public Views on Major Rail Consolidations</u>

Dear Secretary Williams:

Enclosed for filing are a signed original and 25 copies of Comments of National Grain and Feed Association Pursuant to Advance Notice of Proposed Rulemaking in the above-captioned case. Also enclosed is a diskette in WordPerfect 5.1 containing the same document.

Sincerely,

Andrew P. Goldstein

Andrew P. Goldstein
Attorney for
<u>National Grain and Feed Association</u>

Enclosures

APG/rmm

198629

ORIGINAL

RECEIVED
MAY 16 2000
MAIL
MANAGEMENT
STB

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

ENTERED
Office of the Secretary
MAY 16 2000
Part of
Public Record

COMMENTS OF NATIONAL GRAIN AND FEED ASSOCIATION PURSUANT TO ADVANCE NOTICE OF PROPOSED RULEMAKING

David C. Barrett, Jr.
Counsel for Public Affairs
National Grain and Feed Association
Suite 1003
1250 Eye Street, N.W.
Washington, DC 20005
(202) 289-0873

Andrew P. Goldstein
McCarthy, Sweeney & Harkaway, P.C.
Suite 600
2175 K Street, N.W.
Washington, DC 20006
(202) 393-5710

Attorneys for
National Grain and Feed Association

Dated: May 16, 2000

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF NATIONAL GRAIN AND FEED ASSOCIATION PURSUANT TO ADVANCE NOTICE OF PROPOSED RULEMAKING

I. INTRODUCTION

National Grain and Feed Association ("NGFA") is commenting in response to the Board's Advance Notice of Proposed Rulemaking ("ANPR"). NGFA is the U.S.-based trade association for over 1,000 grain, feed, processing and grain-related companies operating 5,000 facilities that store, handle, merchandise, mill, process and export more than two-thirds of all U.S. grains and oil seeds. About 70% of NGFA member firms are small businesses -- country elevators and feed mills. Also affiliated with NGFA are 36 state and regional grain and feed associations.

These comments are not intended to assert NGFA's position on any specific rail consolidation proposal. If and when specific proposals are filed with the Board, NGFA and its individual members expect to assess each proposal on a case-by-case basis. Nor, by these comments, does NGFA wish to suggest to the Board or others a lack of recognition for the significance of efficiencies that will enhance the ability of the rail industry to provide transportation service to the agricultural community. NGFA is, in fact, deeply concerned about the future economic health of the entire rail industry, including Class II and Class III railroads.

Nevertheless, NGFA recognizes that consolidations between two or more large railroads can be problematic, as several such consolidations have been in the recent past. Accordingly, NGFA commends the Board for providing this timely opportunity for a reassessment of matters that should be considered in the evaluation of Class I rail consolidations. It is NGFA's view that if future consolidations are to go forward, they should proceed under rules and guidelines reflecting the contemporaneous state of the rail industry, including competition and market power, and therefore be subject to appropriate new considerations and standards.

II. NGFA COMMENTS

NGFA developed a number of criteria[1] as part of the initial proceeding and four-day hearing held by the STB on the subject of major railroad consolidations and the present and future structure

[1] As a broad-based trade organization, NGFA attempts to develop a consensus among its members. However, individual NGFA members may differ in whole or in part from the consensus views of NGFA or may find it propitious to emphasize certain issues which their individual companies deem to be of great significance, and may file separate comments.

of the North American railroad industry. Those criteria included the following:

1. Efforts by railroads to gain further efficiencies or add capacity that promote growth for U.S. agriculture should be supported. The impacts on shortline and regional railroads of such efforts by Class I railroads should be carefully analyzed because significant quantities of grain and food products originate and/or terminate on the nation's shortline and regional railroads.

2. Where Class I rail consolidations are approved, conditions should be imposed that at least preserve competition. These conditions should include:

a) guarantees designed to keep all existing rail gateways open - *both physically and economically*;

b) reciprocal switching guaranteed at competitive rate levels. This can sometimes be accomplished through bilateral switching agreements between carriers; and

c) any reductions in route or service options because of the merger must be remedied prior to approval of the merger. For example, if the merger results in the creation of a new "bottleneck," then the merged railroad must be required to quote rail users a separately challengeable rate to a competing carrier under all circumstances.

3. Railroads should provide market-based compensation to rail users damaged by service disruptions related to implementation of a rail merger or combination. Pre-merger promises or guarantees

should be in writing and contain objective and enforceable standards. For agricultural rail users, the NGFA suggests the use of the NGFA Arbitration System[2] for fair, prompt and cost-efficient resolution of any merger-related disputes the parties cannot mutually resolve. This suggestion is not meant to replace the need for STB-imposed consolidation conditions.

4. The STB should require more pre-merger financial scrutiny regarding the impact of a proposed merger or combination on the financial health of the resulting entity or entities. Greater emphasis should be placed on determining whether the applicants' claims, if any, of traffic growth are realistic.

5. Where transnational mergers or combinations are proposed, the STB should completely analyze and determine the effect of a foreign government's jurisdiction on rail operations[3] of the resulting entity or entities. Distribution of rail equipment or service and the influence of governing authorities on equipment or

---

[2] The NGFA administers what is believed to be North America's oldest industry-based arbitration system. The NGFA and all of North America's Class I railroads (and several regional and shortline railroads) reached an historic agreement in 1998 to use the NGFA Arbitration System for resolving specified railroad-rail user disputes. The NGFA Rail Arbitration Rules were expanded to additional issues in July 1999 and extended to October 1, 2001. The agreement constitutes an enforceable pre-dispute arbitration agreement for the signatory railroads and NGFA-member rail users executing their consent to the agreement. Parties also can mutually agree to arbitrate additional issues not specified in the NGFA Rail Arbitration Rules. Thus, the rules already could accommodate a condition requiring a consolidating carrier to arbitrate disputes with NGFA-member rail users.

[3] For example, will the foreign government influence the allocation of rail cars? How will conflicts of law be resolved if a loss and damage claim arises on a cross-border movement?

service allocation are significant issues.

6. Rail customers should not pay for merger premiums paid by acquiring railroads or other entities, nor should such premiums be included in the Board's calculations of revenue adequacy. Excessive consolidation-related investments should be the responsibility of railroad management, not their customers.

7. The approval of further rail mergers or combinations should include an analysis of whether changes in national transportation policy are necessary to ensure or enhance intermodal competition.

The STB in its ANPR announcing this proceeding sought input on specific additional issues. NGFA, therefore, has used the above criteria it previously developed to address the issues raised in the ANPR (primarily in the order that the ANPR raises issues for consideration).

Response to ANPR

Downstream Effects. The ANPR states that "we [the Board] definitely intend to propose ... elimination of the 'one case at a time' rule.... We would examine in all future major merger proceedings the likely 'downstream' effects of a proposed transaction, including the likely strategic responses to that transaction by non-applicant railroads."

Inasmuch as the Board already has determined to make this change in the merger rules, a protracted discussion of this issue is unnecessary. NGFA believes that the consideration of "downstream" effects clearly is appropriate in light of the governing statutory standards at 49 U.S.C. § 11324, which direct the Board to consider various specific factors, including "at least -- (1) the effect of the proposed transaction on the adequacy of transportation to the public; (2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction; ... (5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system."

Where a pending consolidation prompts a responsive consolidation by two or more other carriers, it almost certainly would be advisable for the Board to consider such responsive cases simultaneously to the extent compatible with the timetable in Section 11325. Where, however, a pending merger does not lead concurrently to an independent, responsive transaction by two or more other carriers, it is difficult, at least for shippers, to consider "downstream effects" of unspecified mergers in a vacuum, and clarification of the Board's intentions in this respect would be helpful.

NGFA does urge the Board to make every effort to examine thoroughly the impact of any proposed consolidation on smaller, non-Class I railroads. These carriers provide extensive rural rail service, and their continued ability to remain competitive is a matter of great concern to NGFA.

Maintaining Safe Operations. The ANPR indicates that the Safety Integration Plans ("SIPs") formulated by merger applicants in conjunction with the Federal Railroad Administration ("FRA") and the pending proceeding in Ex Parte No. 574, Regulations on Safety Integration Plans Governing Railroad Consolidations, et al., appear adequate for the time being to resolve merger-related rail safety issues.

NGFA, which recognizes the importance of rail safety, does not challenge those conclusions, but suggests that safe rail operating conditions have significance in addition to the protection of human life or property. Safe operating conditions may also affect rail service and performance, for the obvious reason that lines permitted to fall into disrepair normally cause slower operating conditions. As part of a post-merger service monitoring process (discussed, infra, under the heading "Safeguarding Rail Service"), a merged carrier should be required to provide an inventory of pre-merger and post-merger track conditions and operating speeds, if the Board determines that these data would be productive, to serve as a barometer of whether there may be inattention to track maintenance as a result of other post-merger demands on the carrier.

Safeguarding Rail Service. The ANPR offers this issue to stimulate a discussion of such matters as whether there is a need for post-merger performance standards, service integration plans, enforceable penalties to assure against merger-related service degradation, and service preservation options.

The Board should adopt rules that require the merged or consolidating carriers to make full and timely compensation for any and all commercial losses (including special and consequential damages) suffered by their customers as a result of a merger. When service problems have occurred following recent mergers, the carriers often have rejected certain types of claims arbitrarily, even though merger-related. Such responses have involved claims for business interruption, production slow-downs, contract defaults, and diminished utilization of private rail cars.

The Board's rules should make it clear that no claims that are merger-related may be rejected purely as a matter of carrier policy, and that the carriers must be responsible for the full established consequences of merger-related service failures, including, but not limited to, consequences such as plant disruptions, processing or manufacturing slow-downs, curtailed shipments, interference with normal private car cycling, modal substitutions for clogged rail service, and contract defaults or contract penalties. A carrier's liability, at least under 49 U.S.C. § 11706, is not confined to property damage only; carriers are liable for economic, or utility, loss to goods, Hector Martinez & Co. v. Southern Pacific Trans., 606 F.2d 106 (5th Cir. 1979). In reliance on various Supreme Court decisions, the ICC found that Section 11706 is "comprehensive enough to embrace [all damages] resulting from any failure to discharge a carrier's duty [with respect] to any part of the transportation." Liability for Contaminated Covered Hopper Cars, 10 I.C.C. 2d 154, 166 (1994). Even consequential damages are recoverable. Ibid. The Board's merger rules should make it plain that carriers may not arbitrarily refuse to entertain claims for any form of merger-related damages.

NGFA urges the Board to closely monitor all future major mergers for the purpose of holding carriers accountable economically for any damage suffered by their customers. The monitoring process should last as long as there is evidence that the merger is affecting rail service adversely. The specific nature of the monitoring can be established through an STB-approved transaction council/panel (similar to the Conrail Transaction Council) or through some other mechanism. NGFA submits, however, that the Board should collect data that will ensure the enforceability of performance assurances made by carriers seeking to merge or combine operations. This data should include cycle times and other meaningful shipment data on a corridor-by-corridor basis.

NGFA recognizes that the Board may not have jurisdiction to make individual damage awards in all instances, or may not otherwise be equipped to encourage and undertake the wholesale resolution of individual shipper damage claims. That should not deter the Board, however, from making plain under its merger conditioning authority in Section 11324(c) the appropriate ground rules for the resolution of commercial damage claims, including the concept of full liability. Having established those concepts, and assisted in their resolution through a monitoring process, the Board can defer the resolution of individual shipper claims to appropriate dispute resolution forums. It would be appropriate for a shipper to establish a nexus between its individual claim(s) and a merger-related event, along with specific damages, in order to prevail on such a claim.

In that vein, NGFA urges the Board to encourage the use of private-sector arbitration to resolve such disputes. NGFA itself has an arbitration system which is available where one of the disputants is an NGFA member or, in certain instances, where a railroad and an NGFA member have agreed to resolve certain disputes under that arbitration system. The Board also has an arbitration procedure that is available on a voluntary basis. Under its merger conditioning authority, it can require the merging carriers to agree to arbitration if requested to do so by a shipper claiming merger-related damages.

In addition to advancing the resolution of private damage claims, the Board's merger rules should more aggressively elicit post-merger service plans from the applicant carriers and step in to enforce adherence to those service plans where they are being ignored post-merger without appropriate justification.

Promoting and Enhancing Competition. The ANPR states that the Board has concluded "that the time has come to consider whether we should alter our rail merger policy to place a greater emphasis on enhancing, rather than simply preserving, competition." NGFA believes that it is appropriate to take certain steps in that direction.

One such step must involve open gateways and market accessibility. NGFA members report that they have lost market access as a consequence of recent rail mergers when rate structures are altered to deter the flow of traffic over gateways. A condition requiring merging carriers to keep existing gateways open, therefore, needs to apply not just in terms of the physical opening of a gateway, but also in terms of economic gateway access. It makes no sense to require that routes be maintained over gateways if the use of those routes can be defeated by rate increases that effectively embargo the use of the gateway. Accordingly, NGFA proposes that conditions requiring the retention of existing gateways be accompanied by provisions that bar the merged carrier from raising its rates over the gateway to any greater extent than the carrier has raised its system-wide actual (not just paper) rates for the same commodities moving in the same quantities, the goal being to ensure that shippers and receivers are not in a worse position after the merger than previously.

Reciprocal switching is another area that NGFA believes should not be overlooked in future rail mergers. The ANPR reflects a preference on the part of the Board for voluntary agreements, such as the one in the CSX/NS/Conrail transaction, to utilize a "shared assets area" or for other voluntary agreements, including switching, at an agreed-upon fee. NGFA fully supports that approach, but urges the Board not to necessarily rely only on voluntary agreements. For example, in the CSX/NS/Conrail transaction, CSX and NS agreed not to charge more than $250 per car for reciprocal switching over a defined period of time. However, $250 per car could be in excess of the jurisdictional rate threshold of 180% of variable costs and could be sufficiently high to deter the interchange of cars in many instances. In the western U.S., Burlington Northern Santa Fe and Union Pacific have come to an agreement on reciprocal switching that is commonly understood by their customers to involve rates between $70 and $130 per car.

NGFA believes that the appropriate approach to reciprocal switching is to require that such switching be provided at rates not to exceed 180% of variable costs, with the understanding that carriers are, of course, free to establish lower rates if they wish.

Competitive options for shippers should also be protected by a requirement for rate quotations to or from an interchange point where the merger creates any new "bottleneck" situations. Each such quotation should be subject to independent challenge if it meets the jurisdictional requirements for rate reasonableness regulation. NGFA does not believe that a contract with the "non-bottleneck" carriers should be a requirement for this relief where a bottleneck is a product of the merger.

Short Line and Regional Railroad Issues. As mentioned previously, NGFA has deep concerns regarding the future of the non-Class I railroad industry in the United States. In many respects, the goals of the short line "Bill of Rights" (compensation for service failures, the right to interchange and routing freedom, the right to competitive and non-discriminatory pricing, and the right to fair and non-discriminatory car supply) are similar to shipper aspirations, although some NGFA members do question whether a short line railroad has the same entitlement to car supply from a Class

I railroad as do the Class I railroad's own customers.

__Employee Issues__. NGFA takes no position on employee issues, as such. Thus, NGFA neither supports nor opposes the issue noted by the ANPR, which is whether the Board should require merger applicants to agree to forego any effort to "cram down" post-merger changes in collective bargaining agreements pursuant to 49 U.S.C. § 11321(a).

NGFA must note, however, that the "cram down" authority in Section 11321(a) is not restricted to collective bargaining agreements. In the CSX/NS/Conrail transaction, the Board in fact relied on this broad grant of authority to suspend certain agreements between Conrail and its customers pertaining to choice of rail carriers as successors to Conrail.

NGFA believes that, if the Board takes steps to require merger applicants to agree to forego any effort to cram down collective bargaining agreements, the Board similarly should require applicants to agree to forego any effort to unilaterally cram down agreements with those shippers who insist on adherence to existing agreements. This does not preclude parties from mutually agreeing to modify existing contracts.

__Three-To-Two Issues__. The ANPR asks whether merger rules should reflect a recognition that "three-to-two" reductions in rail service are anticompetitive, or instead "whether this issue is best left to a case-by-case examination based on the individual circumstances of each case, as it has been in the past."

As far as NGFA is aware, past efforts by shippers to object to rail mergers that would reduce competitive options from three to two uniformly have been rebuffed by the Board (or by the Interstate Commerce Commission before it). NGFA is opposed to a continuation of that approach, and favors recognition in merger rules of "three-to-two" situations as potentially harmful reductions in competition.

A carrier that acquires another railroad enhances its market power over its customers and enhances its ability to use that enhanced power to be more demanding in any negotiations with shippers that the market may permit. The Board's fundamental premise in the past -- that only a shipper reduced to single-carrier service by a merger is being harmed by the merger -- erroneously assumes that all railroads are equal in market power. That incorrect assumption should not be perpetuated. At the very least, the Board should require the merging railroad to assume the burden of proving that any market realizing a service reduction from three carriers to two will not suffer any adverse competitive impacts.

Merger-Related Public Interest Benefits. The ANPR indicates that this topic is intended to focus attention on three issues: whether the Board should be more critical and skeptical of applicant's estimates of the synergies and other public interest benefits that would be produced by a proposed merger; whether the Board should conduct post-merger monitoring to help insure that the projected benefits are actually realized; and whether the merger applicants should be required to show that any claimed synergies or other public interest benefits could not be achieved short of merger, through marketing alliances or cooperative operating practices.

NGFA encourages the Board to indeed be more skeptical of the public interest benefits claimed by merger applicants. The public interest standard in Section 11324 which governs mergers requires the Board to consider, and balance, several specific criteria, and the Board's merger rules, at 49 C.F.R. § 1180.7, 1180.8, 1180.9 require Class I merger applicants to submit market analyses, operational data, and financial information. So far as NGFA can determine, nothing in the regulations expressly requires any particular demonstration of public interest benefits, except as those benefits may be derived from marketing, operating, and financial data. NGFA believes that the Board should require applicants to specify clearly those respects in which the applicants believe that the merger will lead to public interest benefits. The Board should not require rail customers to bear the costs of merger premiums paid for the acquired carrier, nor should such premiums be included in the Board's calculations of revenue adequacy.

Cross-Border Issues. Cross-border issues can emerge in a number of forms. They have the potential to be especially troublesome in any merger or consolidation resulting in control of a U.S. carrier by a foreign carrier. Since it is not possible to anticipate all potential cross-border problems that may arise from a multi-national railway consolidation, NGFA believes that the

Board should require applicants in cross-border consolidations to present detailed plans addressing car distribution, marketing, and route rationalization, and that the Board should retain the right to enforce any departure from those presentations through injunctive or similar means. Additionally, the Board's merger rules should interdict carriers from applying foreign law to govern any rail transportation in the United States.

Respectfully submitted,

David C. Barrett, Jr.
Counsel for Public Affairs
National Grain and Feed Association
Suite 1003
1250 Eye Street, N.W.
Washington, DC 20005
(202) 289-0873

Andrew P. Goldstein
McCarthy, Sweeney & Harkaway, P.C.
Suite 600
2175 K Street, N.W.
Washington, DC 20006
(202) 393-5710

Attorneys for
National Grain and Feed Association

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing pleading has been served on all parties of record by first class mail, postage prepaid, this 16th day of May, 2000.

Andrew P. Goldstein

Andrew P. Goldstein

g:\mcd\ngfa.582